

Before the  
**FEDERAL COMMUNICATIONS COMMISSION**  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
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**In The Matter of**

**FEDERAL-STATE JOINT BOARD  
ON UNIVERSAL SERVICE**

**CC Docket No. 96-45  
(Report to Congress)**

**COMMENTS OF THE  
TELECOMMUNICATIONS RESELLERS ASSOCIATION**

**TELECOMMUNICATIONS  
RESELLERS ASSOCIATION**

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## **SUMMARY**

The Telecommunications Resellers Association ("TRA"), a national trade association, representing more than 650 entities engaged in, or providing products and services in support of, telecommunication resale, submits that the Commission's implementation of the universal service provisions of the Telecommunications Act of 1996 are inconsistent with the "plain language" of the statute in the following two respects:

First, the contributory scheme by which universal service support will be funded has proven to be neither competitively neutral nor equitable and nondiscriminatory as it applies to non-facilities-based (and to a lesser extent, switched-based) resale carriers; indeed non-facilities-based resale carriers are bearing a disproportionate share of the financial burden associated with universal service funding. Second, the restraints imposed by the Commission on carriers' ability to communicate with their customers regarding universal service-related charges conflict with the Congressional mandate that contributions to universal service be explicit.

TRA strongly urges the Commission to remedy these critical deficiencies in its implementation of Section 254.

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TELECOMMUNICATIONS RESELLERS ASSOCIATION**

The Telecommunications Resellers Association ("TRA"), through undersigned counsel and pursuant to *Public Notice*, DA 98-2 (released January 5, 1998) (the "*Notice*"), hereby submits the following comments on selected issues to be addressed by the Commission in its report to Congress on the consistency of the Commission's implementation of the universal service provisions of the Telecommunications Act of 1996 ("Telecommunications Act") with the "plain language" of the statute.<sup>1</sup> As TRA will discuss in greater detail below, the administration of the mechanisms adopted by the Commission for preserving and advancing universal service is inconsistent in two key respects with the text of Section 254 of the Communications Act of 1934, as amended ("Communications Act").<sup>2</sup> First, the contributory scheme by which universal service support will be funded has proven to be neither competitively neutral nor equitable and nondiscriminatory as it applies to non-facilities-based (and to a lesser extent, switched-based) resale

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<sup>1</sup> Pub. L. No. 104-104, 110 Stat. 56, § 101(a), 102 (1996).

<sup>2</sup> 47 C.F.R. § 254.

carriers; indeed non-facilities-based resale carriers are bearing a disproportionate share of the financial burden associated with universal service funding. Second, the restraints imposed by the Commission on carriers' ability to communicate with their customers regarding universal service-related charges conflict with the Congressional mandate that contributions to universal service be explicit. TRA strongly urges the Commission to remedy these critical deficiencies in its implementation of Section 254.

## **I.**

### **STATEMENT OF INTEREST**

A national trade association, the Telecommunications Resellers Association represents more than 650 entities engaged in, or providing products and services in support of, telecommunication resale. TRA was created, and carries a continuing mandate, to foster and promote telecommunications resale, to support the telecommunications resale industry, and to protect and further the interests of entities engaged in the resale of telecommunications services.

Virtually all of TRA's resale carrier members are providers of interstate telecommunications services, and hence, are required to contribute a portion of their end-user revenues to fund the universal service support mechanisms adopted by the Commission. TRA's resale carrier members, however, are also business customers of their underlying network service providers, some of which apparently intend to treat their resale carrier customers like other business customers and assess on them universal service charges, thereby requiring resale carriers to indirectly contribute twice to the funding of universal service. Moreover, because they do not acquire exchange access directly from local exchange carriers ("LECs") for all or part of their traffic, TRA's non-facilities-based resale carrier members have not benefitted from Commission-mandated access

charge reforms, cost savings associated with reductions in interstate access charge having generally not been passed through to resale carriers by their underlying network service providers. Hence, for non-facilities-based resale carriers, contributions to universal service represent dramatic cost increases with no offsetting reductions in cost.

While the telecommunications resale industry is a maturing market segment comprised of an eclectic mix of established, publicly-traded corporations, emerging, high-growth companies and newly-created enterprises, the "rank and file" of TRA's membership is still comprised of small to mid-sized carriers serving small to mid-sized businesses. The average TRA resale carrier member has been in business for five years, serves 10,000 customers, generates annual revenues of \$10 million and has in the neighborhood of 50 employees.<sup>3</sup> More than half of TRA's resale carrier members are non-facilities-based providers, with many of the remainder being "switch-based" only for a portion of their traffic. In other words, the average TRA resale carrier member is an entrepreneurial entity, which has gained a solid, but nonetheless competitively precarious, foothold in the telecommunications industry.

The average customer of a TRA resale carrier member is a commercial account generating \$100 to \$1,000 of usage a month. TRA's resale carrier members provide their small to mid-sized business customers with access to rates otherwise available only to much larger users.

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<sup>3</sup> Roughly 30 percent of TRA's members have been in business for less than three years and over 80 percent were founded less than a decade ago. While the growth of TRA's resale carrier members has been remarkable, the large majority of these entities remain relatively small. Nearly 35 percent of TRA's members generate revenues of \$5 million or less a year and less than 20 percent have reached the \$50 million revenue threshold. Additionally, nearly seventy-five percent of TRA's resale carrier members employ less than 100 people and nearly 50 percent have workforces of 25 or less. Nonetheless, more than a third of TRA's resale carrier members provide service to 25,000 or more customers. Source: TRA's "1997 Reseller Membership Survey & Statistics" (Sept. 1997).

They also offer these small to mid-sized business customers enhanced, value-added products and services, including a variety of sophisticated billing options, as well as personalized customer support functions, that are generally reserved for large-volume corporate users. And TRA's resale carrier members have been at the forefront of industry efforts to diversify and expand service and product offerings, endeavoring in so doing to satisfy in a convenient and cost effective manner not only all of the telecommunications needs, but other requirements, of small to mid-sized business customers.

TRA's resale carriers have also been the source of, or one of the driving forces behind, many of the service innovations that have helped to fuel the dramatic growth of telecommunications use and revenues over the last decade. For example, prepaid services, including pre-paid calling cards, pre-paid local service and pre-paid wireless services had their genesis in the resale community.<sup>4</sup> Likewise, international call-back and many of the other alternative international services that have exerted downward pressure on accounting rates and on foreign calling prices were developed and originated by resale carriers.<sup>5</sup> Resale carriers have been among the leaders both in developing affinity programs through which a percentage of telecommunications revenues are contributed to organizations or causes and in identifying and accommodating underserved market

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<sup>4</sup> Pre-paid services serve a variety of public interest functions. For example, the Commission has recognized that pre-paid calling card services, among other things, are often "[l]ow-cost services targeted to meet the needs of those with low incomes or non-permanent living arrangements." The Commission's Rules and Policies to Increase Subscribership and Usage of the Public Switched Network (Notice of Proposed Rulemaking), 10 FCC Rcd. 13003, ¶ 38 (1996).

<sup>5</sup> The Commission, for example, concluded that "[c]all-back advances the public interest, convenience and necessity by promoting competition in international markets and driving down international phone rates." Via USA, Ltd. and Telegroup, Inc., 10 FCC Rcd. 9540, ¶ 1 (1995)

niches.<sup>6</sup> And resale carriers have played a key role in the dramatic growth in the availability and use of internet services, including internet telephony. Indeed, given the far greater size and financial, marketing and operational resources of their principal competitors, resale carriers have no choice but to continue to innovate if they are to survive and prosper.

The impact of regulatory requirements on TRA's resale carrier members tends to be magnified because of their smaller size and relatively limited financial resources. Smaller carriers do not have the traffic volumes over which to spread large new regulatory levies without significantly increasing rates. Nor do smaller carriers have the operating margins within which to absorb such assessments without adversely impacting their financial viability. Hence, the imposition of large new regulatory costs presents smaller carriers with a "Hobson's Choice." Do they attempt to absorb these levies and suffer the adverse financial consequences, or do they attempt to pass them through to customers and suffer the adverse competitive consequences?<sup>7</sup>

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<sup>6</sup> As the Commission has recognized, "small businesses are able to serve narrower niche markets that may not be easily or profitably served by large corporations, especially as large telecommunications expand globally." Section 257 Proceeding to Identify and Eliminate Market Entry Barriers for Small Businesses (Notice of Inquiry), GN Docket No. 96-113, ¶ 6 (1996).

<sup>7</sup> The small business customers of TRA's resale carrier members are highly resistant to the imposition of additional charges, particularly large, unanticipated assessments. The experience of TRA's resale carrier members in attempting to pass through payphone compensation, paid by them either directly to payphone service providers or to underlying network service providers, has confirmed the intensity of this resistance, as well as the adverse competitive ramifications of attempting to impose large new charges on small commercial accounts. As the Commission has recognized, "[a]s competition intensifies in the markets for local and interexchange services in the wake of the 1996 Act, it will likely lessen the ability of carriers and other providers of telecommunications to pass through to customers some or all of the former's contribution to the universal service mechanisms." Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776, ¶ 855 (1997), *recon.* CC Docket No. 96-45, FCC 97-420 (1997), *pet. for rev. pending sub. nom. Texas Office of Public Utility Counsel v. FCC*, No. 97-60421 (5th Cir., June 24, 1997).



When the universal service assessments are combined with the multi-line business preferred interexchange carrier charge ("PICC"), per-call payphone compensation, the elimination of the "unitary" option for purchasing tandem switched transport, and the massive increase in the tandem switching charge, among other regulatory-driven cost increases, the result is a series of painful "body-blows" dealt by the Commission to the small carrier community. Through regulatory levies and actions which drive up their costs of services, the Commission is doing what competitors have been unable to do -- *i.e.*, thin the ranks of resale carriers. Certainly, Congress did not intend to decimate through implementation of the Telecommunications Act the most vibrant and dynamic segment of the long distance telecommunications industry. In preparing its report to the Congress on implementation of Section 254, TRA, accordingly, urges the Commission to look closely at the adverse financial and competitive impacts its universal service funding mechanism, as well as its access charge reforms and other actions undertaken in implementing the Telecommunications Act, have had, and are having, on small to mid-sized carriers.

## II.

### **ARGUMENT**

#### **A.    The Commission's Implementation Of Section 254 Has       Not Proven In Practice To Be Competitively Neutral**

As the Commission has recognized, Congress "[w]hen it enacted section 254 of the Communications Act, . . . set forth the principles to guide universal service reform . . . and placed on the Commission the duty to implement these principles in a manner *consistent with the pro-*

*competition purposes of the Act.*"<sup>8</sup> Consistent with this view, the Commission "establish[ed] 'competitive neutrality' as an additional principle upon which . . . [it based] policies for the preservation and advancement of universal service."<sup>9</sup> As the Commission explained, competitive neutrality is consistent with Section 254's "explicit requirement of equitable and nondiscriminatory contributions," and "necessary to promote 'a pro-competitive, de-regulatory national policy framework.'"<sup>10</sup> Critically, the Commission concluded that "competitive neutrality rules" would ensure that "no entity receives an unfair competitive advantage that may skew the marketplace or inhibit competition by limiting the available quantity of services or restricting the entry of potential service providers."<sup>11</sup>

The Commission relied heavily upon the principle of competitive neutrality in determining which entities would be required to contribute to the universal service funding mechanism. Thus, for example, the Commission, in relieving carriers that provide only international telecommunications services of any obligation to fund universal service, expressed a preference for a "more competitively neutral outcome" than Section 254(d) seemingly permitted.<sup>12</sup> Likewise, the Commission, in initially requiring private network operators to contribute to the universal service support mechanisms, concluded that the "public interest requires them, as providers of interstate

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<sup>8</sup> Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776 at ¶ 7 (emphasis added).

<sup>9</sup> Id. at ¶ 46.

<sup>10</sup> Id. at ¶ 48

<sup>11</sup> Id.

<sup>12</sup> Id. at ¶ 779.

telecommunications, to contribute to universal service because they compete against telecommunications carriers in the provision of interstate telecommunications."<sup>13</sup> And the Commission relied upon "the principle of competitive neutrality" in extending contribution obligations to payphone aggregators.<sup>14</sup>

The Commission believed that the basis it adopted for computing universal service funding obligations -- *i.e.*, end-user revenues -- was competitively neutral, reasoning that "[b]asing contributions on end-user revenues, rather than gross revenues, is competitively neutral because it eliminates the problem of counting revenues derived from the same services twice."<sup>15</sup> The Commission noted that "[t]he double counting of revenues distorts competition because it disadvantages resellers."<sup>16</sup> As the Commission explained, double counting would disadvantage resellers vis-a-vis non-resellers that sell to end users in the event that carriers "pass on some portion of the cost of contribution to their customers."<sup>17</sup>

As a theoretical matter, the Commission's universal service contribution mechanism seemingly is competitively neutral. Unfortunately, there is often a large gap between theory and reality. As noted above, in practice, the universal service contribution mechanism has imposed upon resale carriers, particularly non-facilities-based resale carriers, a disproportionate share of the cost of universal service. Virtually all of TRA's resale carrier members operate pursuant to long-term

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<sup>13</sup> Id. at ¶¶ 786, 795 - 96.

<sup>14</sup> Id. at ¶¶ 795, 797 - 98.

<sup>15</sup> Id. at ¶ 845.

<sup>16</sup> Id.

<sup>17</sup> Id. at ¶ 846.

contracts with facilities-based interexchange carriers ("IXCs"). Given the disparity in bargaining power,<sup>18</sup> these contracts generally provide for the "pass-through" of new governmental levies, as well as new or increased assessments by exchange access providers, but seldom require a like pass-through of decreases in access costs. Hence, non-facilities-based resale carriers which obtain switched access through their interexchange service providers, rather than directly from LECs, have not seen any reductions in access charges and will likely not see any such reductions until they enter into new contracts one, two, three or more years down the line.

Accordingly, contributions to universal service support represent "pure and simple" cost increases for non-facilities-based resale carriers.<sup>19</sup> Unlike their facilities-based competitors, non-facilities-based resale carriers cannot "net out" these additional assessments against access savings. Indeed, access reform generated cost increases, not cost savings, for non-facilities-based resale carriers. For example, non-facilities-based resale carriers must now pay the multi-line business PICC for the vast majority of their customers without benefit of any reductions in switched access charges.

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<sup>18</sup> As the Commission has recognized in another context, negotiations between facilities-based and resale carriers "are not analogous to traditional commercial negotiations in which each party owns or controls something the other party desires." Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 FCC Rcd. 15499, ¶ 55 (1996), *recon.* 11 FCC Rcd. 13042 (1996), *further recon.* 11 FCC Rcd. 19738 (1996), *further recon.*, FCC 97-295 (Oct. 2, 1997), *aff'd in part, vacated in part sub. nom. Iowa Utilities Board v. FCC*, 120 F.3d 753 (1997) ("Iowa Utilities Board"), *modified* 1997 U.S. App. LEXIS 28652 (8th Cir. Oct. 14, 1997), *pet. for cert. pending sub. nom. AT&T Corp. v. Iowa Utilities Board* (Nov. 17, 1997), *pet. for rev. pending sub. nom., Southwestern Bell Telephone Co. v. FCC*, Case No. 97-3389 (Sept. 5, 1997).

<sup>19</sup> The same is true for "switched-based resellers" with respect to that segment of their traffic which is carried on a "switchless" basis. Most switched-based resale carriers locate switches only in high customer concentration areas, handling traffic from other locations on a switchless basis.

Justifying, at least in part, the imposition on all carriers of large new regulatory assessments by pointing to Commission-mandated cost savings can hardly be said to be competitively neutral when only select carriers derive the benefit of those cost savings. For the terms of their current service contracts, non-facilities-based resale carriers will be seriously disadvantaged, both competitively and financially, simply by contributing to universal service support without benefit of access charge reductions. This competitive and financial disadvantage will be further exacerbated in the event that their underlying network service providers treat resale carrier customers like other business customers and impose universal service charges. Direct contributions to universal service support, coupled with the multi-line business PICC and per-call payphone compensation, will eliminate the profit margins of most small carriers in the event that they are unable to pass-through these new costs to their customers. The additional burden of funding their underlying network service providers' universal service contributions would likely prove fatal for many.

Regulatory reform which produces a diminution in the level of competition and/or the number of competitors in a market is certainly not consistent with the pro-competitive purposes of the Telecommunications Act. Nor are regulatory actions which uniquely and adversely impact small carriers consistent with the Congressional desire to foster greater participation by small business in the telecommunications industry.<sup>20</sup> As the Commission has recognized, "[d]espite the role of small businesses in the economy, and the growth of the telecommunications market, small

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<sup>20</sup> 47 U.S.C. § 257.

businesses currently constitute only a small portion of telecommunications companies."<sup>21</sup> Policies which compound this problem are not well founded.

To remedy this unfortunate lack of competitive neutrality, TRA recommends that the Commission take several actions. First, the Commission should either (i) relieve non-facilities-based resale carriers (and switch-based resale carriers to the extent their traffic is carried on a switchless basis) of the obligation to contribute to universal service funding, or (ii) require facilities-based IXC's to pass through access charge savings to their resale carrier customers on a dollar-for-dollar basis. Second (and in either event), the Commission should preclude facilities-based IXC's from passing through the cost associated with their universal service funding obligations to their resale carrier customers.<sup>22</sup> These simple "fixes" would restore competitive neutrality to the universal service funding mechanism, consistent with the pro-competitive goals of the Telecommunications Act.<sup>23</sup>

Under Section 254(d), the Commission has authority to "exempt . . . a class of carriers" from the obligation to contribute to universal service funding if the "level of the carrier's

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<sup>21</sup> Section 257 Proceeding to Identify and Eliminate Market Entry Barriers for Small Businesses (Notice of Inquiry), GN Docket No. 96-113 at ¶ 6.

<sup>22</sup> While the Commission does not appear to anticipate that facilities-based network service providers will transfer their universal service funding obligations to resale carriers, it has not precluded them from doing so. Indeed, the Commission has "determined that the interstate contributions will constitute the substantial cause that would provide a public interest justification for filing federal tariff changes *and making contract adjustments*." Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776 at ¶ 829.

<sup>23</sup> While the Commission concluded that "small carriers should not be given preferential treatment in the determination of contributions of the universal service support mechanisms solely on the basis of being small entities," TRA has shown here that relief for non-facilities-based resale carriers is justified because they have been denied the benefits of the Commission's access charge reforms and hence are being uniquely disadvantaged by the universal service funding obligations the Commission has imposed on them. Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776 at ¶ 982.

contribution to the preservation and advancement of universal service would be *de minimis*.<sup>24</sup> Such a finding with respect to non-facilities-based resale would be consistent with the Commission's treatment of systems integrators, which the Commission found "provide telecommunications solely through reselling another carrier's services."<sup>25</sup> In the alternative, the Commission could take this action pursuant to its forbearance authority under Section 10 of the Communications Act, based upon the public interest and competitive findings required thereby.<sup>26</sup>

**B. Restrictions Imposed By The Commission On The Ability of Carriers To Communicate With Their Customers Regarding Universal Service-Related Charges Conflict With The Congressional Mandate That Contributions To Universal Service Be Explicit**

The Commission has compounded the adverse impact of its universal service contributory mechanism on smaller providers by limiting the ability of carriers to explain to their customers the genesis of charges imposed to recover universal service contributions. The Commission requires carriers to advise their customers that the pass through of universal service contributions is a voluntary act on the part of the carrier. As stated by the Commission, carriers must provide information "that indicates that the contributor has chosen to pass through the contribution or part of the contribution to its customers."<sup>27</sup>

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<sup>24</sup> 47 U.S.C. § 254(d). TRA submits that the reading of the "legislative history surrounding section 254(d)" which led the Commission to reject this approach was unduly narrow. Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776 at ¶ 982.

<sup>25</sup> Federal-State Joint Board on Universal Service, CC Docket No. 96-45, FCC 97-420, ¶ 278 (Dec. 30, 1997).

<sup>26</sup> 47 U.S.C. § 160.

<sup>27</sup> Federal-State Joint Board on Universal Service, 12 FCC Rcd. 8776 at ¶ 855.

Once again, the Commission is correct on theoretical grounds. The Commission has not ordered carriers to pass through universal service contributions to their customers. Indeed, the Commission has expressly declined to treat recovery of such contributions as mandatory end-user surcharges.<sup>28</sup> Moreover, the Commission has afforded carriers "the flexibility to structure their recovery of the costs of universal service in many ways, including creating new pricing plans subject to monthly fees." <sup>29</sup>

Putting theoretical niceties aside, the Commission, as a practical matter, has compelled small carriers to recover universal service contributions from their customers. As noted previously, small carriers have neither the margins within which to absorb, nor the traffic volumes over which to spread, cost increases of this magnitude. Given already thin profit margins, universal service costs must be recovered from customers if small carriers are to remain financially viable.

The Commission, however, has denied small carriers the ability to communicate to their customers the practical reality of universal service funding obligations. As the Commission has recognized, Congress intended universal service support to be "explicit."<sup>30</sup> One element of rendering universal service support explicit is the elimination of hidden subsidies and the imposition of defined funding obligations. The other element is truthful presentation of the origins of obligations imposed not only on carriers, but on customers, either directly or through carriers.

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<sup>28</sup> Id. at ¶¶ 853 - 54.

<sup>29</sup> Id. at ¶ 855.

<sup>30</sup> Id. at ¶ 750.



Allowing small carriers to convey to their customers that universal service charges had their genesis in governmental action and are not only not a surreptitious means of raising rates to increase profitability, but in fact are a practical necessity, would minimize the competitive impact of such charges for small carriers. Small carriers should not be required to bear the brunt of consumer anger resulting from governmental decisions. If a policy is worth adopting, it is worth defending. The pretense that small carriers are not being compelled to pass through universal service contributions should be dropped and the Congress and the Commission should acknowledge the position in which they have placed the small carrier community.

### **III.**

### **CONCLUSION**

By reason of the foregoing, the Telecommunications Resellers Association urges the Commission to remedy the inconsistencies between its implementation of the universal service provisions of the Telecommunications Act and the "plain language" of the statute in a manner consistent with the above.

Respectfully submitted,

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## **CERTIFICATE OF SERVICE**

I, Marie E. Kelley, hereby certify that copies of the foregoing document were mailed this 26th day of January, 1998, by United States First Class mail, postage prepaid, to the individuals on the attached service list.

  
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